IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 9

UNITED STATES OF AMERICA, *Appellant*

v.

SEALY, INC., *Respondent*

On Appeal from the United States District Court for the Northern District of Illinois

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Brief Amicus Curiae of Serta Associates, Inc. and Thirty-Six Mattress Manufacturers

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INDEX

CITATIONS

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This brief *amicus* is submitted, upon the written consents of the parties to this appeal on file with the Court, on behalf of Serta Associates, Inc., and the following mattress manufacturers:

Adam Wuest, Inc.	Cincinnati, Ohio
Alexandria Bedding Co.	Alexandria, Louisiana
Augusta Bedding Company	Augusta, Georgia
C. F. Lottman & Sons	Houston, Texas
Capital Bedding Company	Harrisburg, Pennsylvania
Chattanooga Mattress Co.	Chattanooga, Tennessee
Coyne Mattress Co., Ltd.	Honolulu, Hawaii
Dixie Bedding Co.	Greensboro, North Carolina
Dormae Products, Inc.	Austin, Texas
Enterprise Mattress Co., Inc.	Westbrook, Maine

Enterprise-Moakler Co., Inc.	East Cambridge, Massachusetts
Hand-Craft Bedding Corp.	Buffalo, New York
Herr Mfg. Co., Inc.	Lancaster, Pennsylvania
HonorBilt Products, Inc.	Philadelphia, Pennsylvania
Kentucky Sanitary Bedding Co.	Louisville, Kentucky
L. G. Doup Co.	Omaha, Nebraska
Mohawk Bedding Corp.	Utica, New York
National Bedding & Furniture Industries, Inc.	Memphis, Tennessee
Palm Beach Bedding Co.	West Palm Beach, Florida
Palmer Bedding Co.	Denver, Colorado
Palu Bedding Co.	Oklahoma City, Oklahoma
Puerto Rico Bedding Co.	Caguas, Puerto Rico
Quality Mattress, Inc.	Cleveland, Ohio
Royal Bedding Co.	St. Louis, Missouri
Salt Lake Mattress Mfg. Co.	Salt Lake City, Utah
San-Hygene Furniture Mfg. Co.	Akron, Ohio
Schultz & Hirsch Co.	Chicago, Illinois
Serta of Washington, Inc.	Washington, D.C.
Serta-RESTOKRAFT Mfg. Co.	Detroit, Michigan
Simon Mattress Mfg. Co.	San Francisco, California
Sleepmaster Products Co., Inc.	Newark, New Jersey
Sound Mattress & Felt Co.	Tacoma, Washington
Star Bedding of Pittsurgh	Pittsburgh, Pennsylvania
Superior Bedding Co.	Los Angeles, California
Supreme Bedding Co.	Phoenix, Arizona
The J. C. Hirschman Company	Indianapolis, Indiana

Serta Associates, Inc. is a trademark licensing company, from which the manufacturer *amici* hold licenses and against which a Government antitrust complaint is pending similar to the one against Sealy, Inc. that is the subject of this appeal.

This brief is submitted for the primary purpose of bringing to the attention of the Court certain industry facts and conditions deemed relevant to the underlying issues on this appeal—the effect of territorial exclusives on competition in the mattress industry and their legality as restraints reasonably ancillary to a valid trademark licensing arrangement. The struc-

ture, history and operations of Serta Associates, Inc. differ in some substantial respects from that of Sealy, Inc. and quite possibly from that of the other trademark licensing companies in the mattress industry, but we believe that all such companies serve a useful pro-competitive purpose and that the grant of territorial exclusivity to their licensees is necessary to their competitive functioning.

STATEMENT OF INDUSTRY FACTS

(a) The early history of Serta Associates, Inc.

Serta Associates, Inc. (then known as Guardian Knight Corporation) was founded in 1931, at a time when, for reasons which will shortly be set forth, conditions were quite critical for the independent mattress manufacturer. According to Census figures, the total number of mattress and bedspring establishments had declined from 1018 in 1925 to 781 in 1931 and 645 in 1933. Because of these critical conditions, many of the small, local manufacturers that subsequently formed Serta Associates, Inc. adopted and were proceeding to implement, prior to the stock market crash of 1929, a merger plan that would have involved their elimination as independent business entities. The financial, technical and economic details of a 25-company merger had been worked out, and the stock issue placed with Goldman, Sachs and Company.

When the 1929 crash caused abandonment of the proposed merger, Prof. Webster Robinson of the University of California developed an alternative plan, based on a field investigation of the mattress industry during prior years. This plan, which is in effect the present Serta trademark licensing system, involved the retention of manufacturing and distribution au-

tonomy by the individual manufacturer. It was based on an analysis of the technological and marketing revolution created by the emergence of the Simmons Company as the dominant national manufacturer of mattresses, and the competitive disadvantages this created for the small, locally-based mattress manufacturer, possessing limited financial resources and manpower.

In 1925, Simmons had introduced its "Beautyrest" innerspring mattress, a much better mattress than those then upon the market, which it advertised to sell at retail for $39.50. Although innerspring mattresses were not then unknown, their sales had been insignificant because they were much more expensive than the then prevalent cotton felt or hair mattress. Moreover, the Simmons "Beautyrest" was backed by an intensive campaign of national advertising. In 1928, Simmons spent $1,500,000 in advertising the "Beautyrest" and, in 1929, $1,700,000—figures completely out of the question for the small independent manufacturer. By virtue of this national advertising, Simmons' "Beautyrest" sales skyrocketed from 16,000 mattresses in 1925 to 300,000 in 1928, and the "Beautyrest" name gained wide public acceptance. See "Back to Beautyrest," Fortune Magazine, January 1937, page 120.

Moreover, the Simmons Company, by maintaining warehouses at many widespread locations, was able to avoid the prohibitively high costs involved in the shipment of small quantities of mattresses over long distances. On the other hand, such freight costs precluded the small independent manufacturer from shipping any significant distances.

In the light of these circumstances, Professor Robinson proposed, to the participants in the abandoned merger plan and others, that their best hope of being able to compete effectively with the Simmons Company was the formation by them of a company which would adopt and register trademarks, license them to the manufacturers, formulate rigid specifications for an improved mattress to which the licensees would adhere and engage in national advertising of the mattresses bearing the licensed trademarks. Guardian Knight Corporation (subsequently Sleeper Products, Inc., Sleeper, Inc. and Serta Associates, Inc., which shall all hereinafter be referred to as "Serta") was organized on January 30, 1931, with its shares of stock being issued to eleven manufacturers.

(b) The origin of Serta's territorial exclusives

Within two months of its organization, Serta entered into an agreement with Nachman Springfilled Corporation, a firm holding important patents on spring units designed for incorporation in innerspring mattresses. Pursuant to this agreement, Serta's licensees were granted the exclusive right to manufacture mattresses under the Nachman patents within a designated territory. They were however authorized to sell these mattresses anywhere in the United States.

At the outset, the freedom of Serta's licensees to sell anywhere in the United States created no problems, because they had been chosen with a view to their geographic location. The licensees' natural areas of sale, determined by costs of shipment, were such that they had never competed with one another; hence, there was no reason to limit their sales territory.

Serta's original efforts to extend its initial membership of eleven proved rather disappointing; despite continuous activity, very few new licensees were added. Prospective licensees had made it clear that they would be unwilling to contribute the funds needed for advertising the Serta trademarks, if another Serta licensee could freely capitalize on their investment and appropriate and dilute the good will which, as independent manufacturers, they desired to build up for themselves. Serta's Executive Committee, accordingly, on November 26, 1932, adopted a policy of assigning its licensees exclusive territories for the sale of Serta-brand products, recognizing that this was necessary to obtain new licensees and thus compete effectively with the Simmons Company.[1] After adopting this policy, Serta in 1933 acquired 11 new licensees and in 1934, 5 more licensees.

(c) Corporate and fees structure of Serta; its territorial allocation policy

Currently and for many years past, Serta's stock has been owned entirely by its licensees, with each of the thirty-six U. S. licensees owning 50 shares of stock and the four Canadian licensees owning from 15 to 50 shares. Each share of stock is entitled to one vote, and there is no cumulative voting. The officers and management of Serta, who are charged with running its day-to-day operations, are not licensees, or representatives or employees of any of Serta's licensees. Their goal has been to maximize sales of Serta-brand merchandise and to increase Serta's revenues.

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[1] Serta's licensees are not required to limit themselves to the sale of Serta-brand bedding, and Serta exercises no control, territorial or otherwise, over the manufacture or sale of such non-Serta products, which is substantial. See p. 15, below.

The major financial contribution of the licensees to Serta is a "market fee" assessed annually. In addition, each licensee pays a $10,000 annual "franchise fee," and makes smaller contributions to a "creative fee" and for national showroom charges. The "market fee," and half of the "creative fee," are assessed against the licensees in proportion to the "buying power index" of their respective territories. The "buying power index," which is published annually for each county in the United States in *Sales Management Magazine,* is established with reference to (1) the population of the county, (2) the total retail sales of the county and (3) disposable personal income after taxes ("effective buying income"). Since the licensee's fees are thus determined by the total consumer potential within his area, it is not in the licensee's interest to insist on holding territory which he cannot adequately serve; by giving up such territory, the amount of his fees due to Serta is reduced. Serta's records reflect at least six occasions on which individual licensees surrendered territories in Florida, Louisiana, Georgia, New Mexico, Texas and Ohio that had originally been allocated to them.

Serta's licensees are allocated no greater territory than they can reasonably be expected to service effectively. They are free to withdraw from Serta upon six month's notice, subject to the payment of all fees and charges then due and payable. Upon withdrawal, the licensee receives credit for the book value of his shares.

It has at no time been intended or proposed either by Serta or its licensees to limit the number of licensees, or to divide markets or territories among the licensees, or to fix permanent territorial boundaries

for licensees. On the contrary, Serta officials have constantly striven to find new licensees to replace licensees that have withdrawn or have proven ineffective, to obtain needed additional sources of revenue for national advertising, and to enable Serta products to be nationally distributed and thereby take full advantage of Serta's extensive national advertising. Thus, of the 36 current Serta licensees, 18 became licensees between 1931 and 1937, 6 between 1943 and 1949, 9 between 1950 and 1960, one in 1962, one in 1964 and one in 1966.

(d) The licensees' stake in the Serta trademarks

Since Serta's formation, the licensees have made substantial payments, both to Serta and to the advertising media, for the purpose of promoting the Serta name and trademarks and building up their own good will in their respective areas. These payments cover the expenses incurred in national magazine advertising; local newspaper advertising (which is "keyed" to the national magazine advertising); Serta's product and trademark development; and the maintaining by Serta of a national showroom in Chicago to take advantage of annual trade meetings and to serve as a showcase for Serta products. For competitive reasons, it is necessary to advertise not only the Serta mark but also numerous product marks designating various price and quality lines carried by Serta's licensees (see p. 13 and Appendix, "Suggested Prices for Mattress Lines," below). In addition to any special promotions on which Serta assists its licensees, it incurs specially heavy expenses for advertising during the industry-wide merchandise promotion periods that take place twice a year.

The sums expended by representative licensees over the years in promoting the nationally known Serta marks are indicated in the following tabulation.

Name of Licensee	Location	Time Covered	Amount Spent[2]
HonorBilt Products, Inc.	Philadelphia, Pa.	1933-1965	$ 971,370.23
Augusta Bedding Company	Augusta, Georgia	1934-1965	$ 482,616.42
Serta of Washington, Inc.	Washington, D. C.	1943-1965	$ 814,791.51
Palmer Bedding Company	Denver, Colorado	1947-1965	$ 444,327.08
Serta-RESTO-KRAFT Mfg. Co.	Detroit, Michigan	1954-1965	$1,291,142.73
Mohawk Bedding Corp.	Utica, New York	1955-1965	$ 359,719.30
Dormae Products, Inc.	Austin, Texas	1960-1965	$ 219,965.63

The national magazine advertising of Serta bedding is completely beyond the financial resources of the individual licensee. In 1966, a one-page, four color advertisement in McCall's Magazine costs $42,840, whereas a newspaper page (approximately twice the size of a magazine page) costs $894 in Austin, Texas and $2,066 in Memphis, Tennessee.

(e) Current competitive structure of the mattress industry

The competitive problem of the individual Serta licensee today is in essence what is was when Serta was created in 1931: How can a small independent mat-

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[2] This figure does not include substantial amounts spent for local advertising of the Serta name and trademarks prior to 1961. The total amount assessed by Serta against the seven above licensees for the year 1966 is $363,645.75; this does not include additional expenditures made by the licensees directly.

tress manufacturer, with limited resources that restrict it to a single factory and a local market, compete effectively with large national integrated firms that are able to utilize the expensive media of national advertising and thereby reach a consumer market not reached by local advertising? In fact, the problem is more acute today, with the increased emphasis on, and greatly increased cost of, national advertising.

Simmons remains the dominant concern in the field. In 1959, the Serta licensees showed estimated aggregate mattress and box spring sales of about 33 million dollars, as compared with about 133 million dollars of total Simmons sales.[3] All Serta licensees are single establishment firms, whereas Simmons in 1960 had 13 plants and 60 warehouses scattered throughout the country.

In 1959, the volume of Serta sales by individual licensees ranged from a low of $183,809 to a high of $2,757,934; 11 licensees had less than $500,000 of Serta sales and 21, less than $1,000,000. Over the 14-year period, 1952 to 1965, inclusive, Serta's total national advertising expenditure on behalf of its 36 licensees amounted to $3,964,467, as contrasted with $28,087,412, or seven times as much, for Simmons.[4]

While Simmons is the dominant firm in the industry, the Serta licensees in their respective localities encounter strong competition from many other manufacturers, including other "national brand" companies

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[3] See 1959 annual Simmons Report to Stockholders. Simmons, it should be noted, sells not only mattresses and box springs, but also dual purpose sleeping equipment competitive with the products sold by Serta's licensees and other items. However, mattress and box spring sales account for the bulk of its business.

[4] "National Advertising Investment," compiled and published by National Advertisers, Inc.

with nationwide advertising coverage and the licensees of other trademark licensing companies. Besides Sealy and Serta, there are other trademark licensing companies in the mattress industry such as, Spring Air, Restonic, Bemco and Sylcon, whose licensees have smaller aggregate and average sales volume than Sealey's and Serta's licensees. In Philadelphia, Pennsylvania, and Augusta, Georgia, the Serta licensees, in 1961, reported about 25 competitors in each of their respective areas.[5]

The current local competitive situation is substantially the same.[6] The prices at which mattresses are sold by the licensees to their department and furniture store retail outlets vary from licensee to licensee and are dependent on the active competition each licensee encounters within his local market, see p. 13, fn. 8, below.

ARGUMENT

I.

The Government's Speculations as to the Competitive Harm Caused by Territorial Exclusives Have No Basis in the Record, in the Facts of the Mattress Industry or in Sound Economic Theory.

The economic considerations advanced by the Government as supporting the application of the *per se* illegality rule to Sealy's territorial exclusives turn out, upon analysis, to be unproven assumptions, with no support in the realities of the mattress industry or the market place.

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[5] Hearings on S. 1396 before the Senate Judiciary Subcommittee on Patents, Trademarks and Copyrights, 87th Cong., 1st Sess., pp. 42, 46.

[6] See the statement of Serta's Augusta licensee in Hearings on Distribution Problems Affecting Small Business before the Senate Judiciary Subcommittee on Antitrust and Monopoly, 89th Cong., 2d Sess., Part 2, p. 704.

Thus, the Government's brief contends that the advertising and promotional activities of the trademark licensing groups create "a distinct image" and a "unique demand" for the trademarked bedding, and that a territorial exclusive consequently gives the licensees "a margin of freedom in pricing" the trademarked product they would not otherwise have (p. 14). More extremely, it is stated that the Sealy licensing program "presupposes that the Sealy brand has a distinct consumer appeal which insulates it, within a range at least, from the competition of other bedding brands," and that the net effect of a territorial restriction is "the direct elimination of all—not merely price—competition in the sale of licensed product" (p. 11).

There is, in our view, no basis of fact for these sweeping and dogmatic assertions.[7] The department and furniture stores to which the mattress manufacturer sells his product are price-conscious, experienced commercial buyers. Unlike the individual consumer, who might be influenced by ignorance, irrationality or non-economic considerations, these retailers are in a position to, and do, make a free choice from among the price and other inducements offered by Simmons, Englander, the licensees under a nationally known mark and other manufacturers engaged in promoting their respective brands. Hence, while the effort of all mattress manufacturers is to build up a "distinctive image" for their product, they do not succeed in establishing a "unique demand" for it.

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[7] Prof. J. M. Clark says with respect to Prof. Bain's study, upon which the Government's generalizations are based, that it "centers on collusive or quasi-collusive oligopoly, limited by potential competition and pricing to forestall the entry of new firms." *Competition as a Dynamic Process* (1961) p. 259. No such situation or practice is involved in this appeal.

Concrete proof of the licensees' lack of insulation from competitive pressures is supplied by the fact that the *wholesale* prices charged to the retailer for Serta bedding vary from licensee to licensee (and, within permissive Robinson-Patman limits, as among different retail customers), depending on competitive prices quoted by the twenty-five or so competitors that the licensee faces within his local market (see pp. 10-11, above).[8] Even in their consumer advertising, the licensees do not possess the "margin of freedom in pricing" their products that the Government imputes to them by virtue of their territorial exclusive. The prospective consumer is looking not only for a mattress, but for a mattress at a certain price level, and the advertising of Simmons and the other national brand manufacturers therefore always covers several lines of mattresses at different suggested consumer prices. The licensees must accordingly, for competitive reasons, follow suit and quote suggested consumer prices similar to those advertised by Simmons and other national manufacturers.[9] It is clearly the consumer, not the licensee, who calls this particular price tune.

The Government's *a priori* theory of product differentiation by trademark creating a unique demand for

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[8] In its complaints against Sealy, Serta and two other licensing organizations the Government charged a conspiracy by the licensees to fix resale prices to the consumer. There was neither a charge nor evidence of a conspiracy to fix the wholesale price to the retailer.

[9] See Appendix, "Suggested Prices for Mattress Lines", containing suggested consumer prices for a list of products offered by the Serta licensee and four competitors. The Government, in the consent judgments entered into with the Spring Air and Restonic licensing companies, has permitted the advertising of suggested consumer prices, thereby acknowledging its competitive necessity.

the trademarked product has limited business applicability. It may have some pertinence for luxury items such as perfumes, where advertising is directed to consumers making regular purchases and with relatively stable tastes, for whom price is a relatively minor consideration. It does not apply to mattresses, which are bought only a few times in a lifetime, where the consumer is so price-conscious that all advertising must carry a suggested consumer price, and regular periodic promotions stressing several price lines are a competitive necessity. "Industries differ in the elasticities of the demand functions which prevail under different kinds and degrees of product differentiation," J. M. Clark, *Competition as a Dynamic Process* (1961) p. 267. Certainly, no *per se* rule of antitrust illegality can be predicated on a criterion that at best applies to only a limited number of industries.

Thus, the territorial restriction does not have the noxious economic consequences attributed to it by the Government. Contrary to the abstract picture painted by the Government, the wholesale prices of the licensee are determined by negotiation with price-conscious, expert retailers, on the basis of price and other competitive considerations; the licensee must advertise several product lines, at suggested retail prices dictated by standard consumer expectations and by industry custom; and the licensee, far from having any immunity from competition, must continually struggle to maintain (and hopefully to increase) his share of the total consumer demand for mattresses. As a major competitive tool in this continuing struggle, the licensee has the good will that he has built up under the licensed mark and the morale of his marketing organization, which the Government now seeks to impair and erode by depriving him of territorial exclusivity.

The Government's brief asserts, without proof, that the main motivation behind the territorial restriction is to insulate the licensee from competition emanating from other licensees (see p. 15). Were this in fact the licensees' motivation, the first thought of Sealy or of Serta would have been either to prevent their licensees from selling non-Sealy or non-Serta mattresses or to place territorial restrictions on such sales. Yet, the record is uncontroverted, and the Government's brief concedes (see p. 14, fn. 7) that Sealey's licensees are free to sell non-Sealy brands free of any territorial restriction, and the same is true of Serta's licensees. Thus, in 1959, the non-Serta bedding sales of ten Serta licensees ranged from 45 percent to 77 percent of their total mattress sales; that of thirteen, from 15 percent to 44 percent of their total; and only ten showed non-Serta sales amounting to less than 15 percent of their total.

Another recurrent, related but equally unsupported motif in the Government's brief is the claim that the purpose underlying the territorial exclusive is to enable licensees "to attain a level of profits that free intrabrand competition would prevent" and to reap "monopolistic profits" (see pp. 22-25). The fallacy underlying this contention has already been demonstrated; the same competitive pressures that serve to keep the licensees' wholesale prices in line (see p. 13, above) necessarily affect their level of profits and keep them from rising to a "monopolistic" level. Where, as in the mattress industry, "the competition is between a substantial number of competitors of unequal size but not-too-unequal strength, their rivalry is likely to generate a cross-elasticity of demand that will prevent quasi-monopoly profits from arising," J. M. Clark, *Competition as a Dynamic Process* (1961) pp. 262-3.

The Government's position is further contradicted, for the mattress industry, by the fact that, for the year 1964, the Serta licensees' percentage of profit to sales amounted to 3.23 percent, as compared with an industry-wide average of profit to sales of 3.71 percent.[10]

It is strange indeed to base even market analysis, much less to justify a principle of absolute legal liability, on as elusive and mythical a concept as "monopoly profits." In actual markets, as opposed to the theoretical models of some economists, the level of profits is an unreliable guide to the identification of monopoly power, Edwards, *Maintaining Competition* (1949) p. 125. It is even stranger to see "monopoly profits" advanced as a justification for a *per se* rule of antitrust illegality, for the courts have recognized that the level of profits (like the level of prices) is irrelevant where either illegal monopolization or *per se* antitrust illegality is involved, see *United States* v. *Aluminum Company of America,* 148 F. 2d 416, 427-8 (C.C.A. 2); *United States* v. *United Shoe Machinery Co.,* 110 F Supp. 295, 325, 342 (D. Mass.) aff'd, 347 U.S. 521; cf. *United States* v. *Trenton Potteries,* 273 U.S. 392.[11]

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[10] The source for this information is a cost and profit survey compiled by Regardie and Brooks, for the National Association of Bedding Manufacturers. The Serta figure is based on information provided by 21 out of the 36 Serta Licensees, which is regarded as representative of all Serta licensees. Serta's licensees do not make cost and profit information available to Serta Associates, Inc. and submit it to Regardie & Brooks only on a confidential basis.

[11] Even were one to assume, *arguendo,* the Government's contention that the desire for "monopoly profits" is relevant to Sherman Act violation, the existence of such a desire can surely not be a matter of judicial notice. The obvious place to establish such a motivation is in the trial court, on the basis of a public record. The Government's own premises therefore run counter to, and not in favor of, the rule of *per se* illegality.

The Government's most intimidating spectre is that the advertising of the trademark licensing companies may

> ". . . weaken competition by raising the barriers to new entry into a market or industry and by impairing the position of smaller firms that cannot spend heavily for advertising. See Bain, *Barriers to New Competition,* p. 142. The very success of the Sealy scheme may make the bedding industry one where only a very large firm or one that belongs to a Sealy-type group can survive" (p. 19).

Here, again, it is pertinent to note that the study upon which this fear is based was focussed on oligopolistic situations where pricing is governed by the desire to forestall the entry of new firms—a situation which does not exist in the mattress industry (see p. 12, fn. 7, above). Also, the Government's undocumented concern with concentration trends is a speculative exercise, appropriate to the preventive philosophy underlying a Section 7 Clayton Act anti-merger proceeding but quite irrelevant to the laying down of a *per se* rule of illegality under the Sherman Act, which is directed against consummated restraints of trade.

There are economic as well as legal answers to the Government's Cassandra-like speculation on the shape of things to come. From the Census figures, there appear to be no barriers to new entry in the mattress industry, even for small firms. The number of companies in the mattress and box spring industry has increased from 842 in 1947 (the first year for which this information is given) to 1158 in 1958.[12] In 1958, there were 838 establishments in the bedding industry

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[12] U.S. Census of Manufactures: 1958, Household Furniture Industry Report MC 58(2)-25A (1960), Table 1, p. 25A-4.

having 19 or less employees and 324 with from 20 to 49 employees.[13] Serta's licensees themselves are in the small firm, one establishment classification. Thus, in 1965, after several years of steady industry growth, out of 31 Serta licensees reporting, 2 were in the Census 10-19 employee classification; 13, in the 20-49 employee category; 9, in the 50-99 employee class; 6, in the 100-199 employee group; and one had 275 employees.

While there are no barriers to the entry of small firms into the mattress industry and no evidence of their elimination therefrom, they do encounter difficulties in competing with the "national brand" companies. In fact, the small independent has the same problems in this respect that the comparably circumstanced licensees of Serta would have if they could not rely on Serta's resources. Without Serta's trademark license, the substantial market reached by national advertising would be lost to the Serta licensee and the small independent alike; it would fall into the lap of the large "national brand" companies. Striking down the territorial restriction would therefore tend only to promote the concentration of business in the hands of the strong national bedding concerns; it would not aid the small independent.

The Government's brief indulges in the optimistic prediction that:—"Successful fulfillment of the Sealy group's promotional activities does not depend upon a territorial restriction" (p. 18). This surmise misconceives and confuses the basic issue, which is not simply the ability of Sealy to carry on national advertising nor the protection of the licensee from loss of sales to outside licensees. The fundamental problem is that, by depriving the licensee of a reasonable and

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[13] *Ibid.*, Table 3, p. 25A-12.

competitively justifiable territorial protection, his individual good will be impaired and the morale of his organization disrupted, with the net result of putting in jeopardy the continued effective functioning of the trademark licensing arrangement and thereby lowering the competitive potential of the industry.

The Government's unsupported assumption that the trademark licensing company will continue successfully to carry out its functions has been flatly contradicted by a representative of one of the smaller licensing companies, who has stated that striking down the territorial restriction will drastically injure his company. Testifying before a Congressional committee, Restonic's representative pointed out that Restonic, which had entered into a consent decree to avoid the cost of litigation, had tried unsuccessfully to procure the consent of the Justice Department to the vacation of the decree and to afford Restonic an opportunity to defend before the District Court. According to Restonic's representative:

> "Since that time it has become increasingly evident that there is no benefit to the licensees if they cannot have exclusive territory within which to develop good will in the trademarked product. Many of Restonic's licensees are already in conflict in seven areas out of the areas in which Restonic-labeled merchandise is sold. Over the period since 1960 several of the licensees resigned and it has been difficult to get new ones. It is only because of the hope that the Sealy litigation now before the Supreme Court will be favorably decided or that the Congress will give relief by adopting the legislation which has been placed before it, that our organization is continuing against such odds."[14]

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[14] See Senate Hearings on Distribution Problems Affecting Small Business, *supra*, fn. 6 at p. 715.

It may be noted that Restonic's licensees are even less significant in the industry picture than Sealy's or Serta's licensees. In 1965, Restonic's 18 licensees, after a period of greatly increased industry sales, had a total annual sales volume of $7,500,000, only 50% to 60% of which represented Restonic trademarked bedding. The individual licensees' total annual sales (including non-Restonic bedding) ranged from approximately $118,000 to $1,300,000, with three licensees having a volume of $1,000,000 or over, four under $250,000, and the remainder from $250,000 to $600,000. Yet, the Government's proposed *per se* rule would deprive even these small factors in the industry of the opportunity to compete on a more equal basis with their larger trade rivals and at the same time preserve and develop their own good will.

Viewed in the sober perspective of the relevant and tangible market facts, the Government's fears of monopolistic and anti-competitive consequences for the mattress industry should this Court fail to adopt a *per se* rule on territorial restrictions are completely unfounded. They rest on speculative assertions and *a priori* economic hypotheses that are at best applicable to special kinds of oligopolistic situations not encountered in the mattress industry. They are so completely at odds with economic reality and sound economic theory as to suggest that the Government is not aware of "the economic and business stuff out of which these arrangements emerge," *White Motor Co.* v. *United States,* 372 U.S. 253, 263. Such fears, buttressed neither by fact nor by theory, do not furnish any valid basis for a rule of *per se* antitrust liability.

II.

The Admission of Evidence on the Competitive Justification for the Territorial Restriction Does Not Unduly Proliferate the Issues before a Court and is Consistent with Fundamental Antitrust Doctrine and Objectives.

The District Court in the present appeal held, at the conclusion of the Government's case and without any evidence being introduced by Sealy, that the Government had failed in its burden of establishing that Sealy's territorial exclusives violated Section 1 of the Sherman Act. That holding necessarily rendered as superfluous the introduction of evidence by Sealy as to the competitive justification for territorial exclusives. In this section of the brief, we take issue with the Government's position, implicit in its advocacy of the *per se* rule, that, had such evidence of competitive justification been tendered, it should have been excluded and, in particular, its rationalization of the *per se* rule as one of judicial economy.

The Government errs in its basic assumption that the alternative to the adoption of a *per se* rule is "broadening the scope of inquiry to include every conceivable relevant fact" (pp. 9-10 of its brief). The actual alternative is the admission of only such evidence as is relevant to the issue whether the challenged practice restrains competition. In a case such as this, where the Government's unilateral presentation resulted in 119 numbered paragraphs of findings of fact on the territorial issue, taking up 40 printed pages, and the record before this Court relevant to that issue consists of almost 1,000 pages of extracts from the Government's exhibits, it would not unduly swell the trial record to permit a defendant to introduce evidence on competitive conditions of the kind contained

in this brief's Statement of Industry Facts, most of which dovetails with the Government's evidence.

The Government's brief exaggerates the "proliferation of the areas of factual inquiry" (p. 9) that would result were the *per se* rule not adopted. Thus, we do not suggest that antitrust defendants may present evidence on whether their prices have been reasonable, the issue to which *United States* v. *Trenton Potteries,* 273 U.S. 392, was directed, or whether their level of profits has been low (see pp. 15-16, above). There is no thought of permitting the introduction of evidence on points relating to the business reasonableness (apart from restraint of competition) of the challenged practice, such as the quality of the goods produced, productive or technological efficiency or any of the other considerations that several writers have considered to be within the scope of the "rule of reason," see Blackwell Smith, *Effective Competition,* 26 N.Y. Univ. Law Review 405, 441 (1951). We do not share the Government's pessimistic view of the ability of trial judges to control antitrust litigation by excluding evidence with no direct bearing on the competitive process.

Sympathetic as one may be to the Government's plea for "simplification" of substantive antitrust principles, this does not extend to their modification. No rule based on administrative considerations of judicial economy supersedes the right of antitrust defendants to plead the reasonable ancillary restraint defense and to introduce evidence relevant to this defense, including that relating to the pro-competitive effects of a challenged practice. If the touchstone of a *per se* illegality of a challenged practice is its "pernicious effect on competition and lack of any redeeming virtue," *Northern Pacific Co.* v. *United States,* 356 U.S.

1, 5, it follows that antitrust defendants should be allowed to present evidence bearing on the salutary competitive effect of the practice, unless it can be conclusively established that such salutary effects are *de minimis* and have "no redeeming virtue." This latter, as has been shown in the preceding section of the brief, the Government has failed to do.

The present appeal involves the territorial exclusive practice in the judicially novel context of a trademarked licensing program necessary to promote effective competition by small companies. Any court passing on such a novel situation is entitled to have before it, if the occasion requires, the market facts relevant to the competitive implications of the practice, as seen both by the plaintiff and the defendant. To hold otherwise would be to put procedural considerations of speed and simplicity of administration ahead of substantive antitrust considerations, and defeat antitrust objectives.

III.

Territorial Exclusives Granted by a Trademark Licensing Company to Small Mattress Manufacturing Licensees, Who are Also its Shareholders, Promote Competition, do not Unreasonably Restrain Trade and are Valid Ancillary Restraints.

Considering the congruity of purpose of Serta and its licensees, it is quite natural that Serta's interests as a trademark licensor should largely coincide with those of the individual licensees. However, this brief has pointed out the various factors in respect of which Serta's policies and position differ from those of its shareholder licensees—Serta's responsibility as a trademark licensor to impose specifications and quality control on its licensees, its desire to expand sales and revenues, its search for new licensees, the "buying

power index" fee system, Serta's withdrawal of territories that are not fully developed, its control over national advertising and the national showroom in Chicago. All of these factors combine to give Serta a pro-competitive, not a restrictionist, outlook. And the divergence between Serta's interests and those of its licensees support viewing the legality of its territorial exclusives as one would that of any other trademark owner imposing a like restriction on its licensees.

In *White Motor,* 372 U.S. 253, this Court reserved decision on whether the manufacturer of a nationally known and distributed branded product, with hundreds of well-equipped distributors, may allocate exclusive territories to such distributors for the exploitation of its brand. It would in our view be ironic if it should be held that a trademark licensing company, performing valid engineering, licensing, advertising and promotional services and motivated solely by the desire to expand its revenues and increase the competitive potential of its licensees, should be foreclosed from assigning exclusive territories to 30 or 36 local manufacturers, with small distribution staffs,[15] merely because the stock of the licensing company was owned by the licensees. But the law as we see it does not call for any such arbitrary and unreasonable result.

Rather than stress the points wherein Serta's interests diverge from those of its licensees, we approach the matter on the alternative assumption that Serta is, in economic effect, a joint venture of the Serta licensees, performing for the licensees a specific func-

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[15] On page 18 above, employment figures were given showing the small business nature of Serta's licensees. Of the licensees' total labor force, it is estimated that only 7% to 9% are sales and distribution personnel.

tion that they could not perform for themselves—that of national trademark promotion and advertising—and enabling them to compete for a segment of the consumer market that would otherwise be monopolized by the "national brand" companies. The individual licensees retain control over their manufacturing and distribution operations; engage in considerable local advertising and promotion; and are unrestricted, territorially or otherwise, with respect to their distribution of non-Serta products.

Accordingly, the purpose of the Serta "joint venture"—to make national advertising opportunities available to small firms that could not otherwise afford it—is much more limited in scope than that of the joint venture upheld in *United States* v. *Columbia Pictures Corp.*, 189 F. Supp. 153 (S.D.N.Y.), twice cited in the Government's brief. In that case, Screen Gems, a wholly-owned subsidiary of Columbia Pictures, a film producer, was granted by Universal, another film producer, the exclusive license for a 14-year period to distribute for television exhibition purposes Universal's entire pre-1948 library of approximately 600 films. Although Columbia and Universal were direct competitors, the Court upheld the arrangement on the ground that:

> ". . . it permits a producer (Universal) who does does not have the ability to engage in proper distribution to engage the distribution facilities (Screen Gems) of a producer (Columbia) who does. It also permits the distributing organization to continue its function, by replenishing its supply of product to distribute" (p. 178).

There have already been set forth in this brief the industry facts which establish territorial exclusivity

as falling within the doctrine of reasonable and permissible ancillary restraints, first enunciated in the classic case of *United States* v. *Addyston Pipe & Steel Co.,* 85 Fed. 271 (C.C.A. 6), *affimed,* 175 U.S. 211, and recently applied in the *Columbia Pictures* case, from which we now quote.

The Serta territorial restriction "is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary" (p. 178). See *Denison Mattress Factory* v. *The Spring-Air Co.,* 308 F. 2d 403 (C.C.A. 5), so holding for another trademark licensing company in the mattress industry. Territorial exclusivity was a necessary condition of obtaining the participation of the licensees in the Serta joint venture, the purpose of which was not only legitimate but pro-competitive. It was also a reasonable and necessary means of preserving to the licensees their individual good will, the retention and development of which is essential to their effective competition.

The Government's brief concedes that temporary territorial restrictions may perhaps be justified if they promote new entry (pp. 13, 20), but argues that permanent restrictions stand on a different footing. On the contrary, our view is that, "reasonably necessary" as the territorial restriction was when the joint venture was organized, it has become even more so over the years, as the licensees have invested increasing amounts of money in the venture, are confronted with greatly accelerated advertising expenditures by the national brand companies and must, for valid competitive reasons, preserve their own good will from dilution. See pp. 8 to 10, above; cf. *Sandura Co.* v. *Federal Trade Commission,* 339 F. 2d 847, 853 (C.C.A. 6).

Nor does the territorial exclusive have any broader scope than necessary. Serta's licensees are not restricted in their substantial sales of non-Serta products; are not obliged to adopt a Serta trade name; are under a financial compulsion to give up their exclusives for areas where they cannot effectively compete; and may terminate their license on reasonable conditions at any time, and have done so.

The Serta territorial restriction "does not unreasonably affect competition in the market place" (189 F. Supp. at 178). In fact, it has enabled the Serta licensees to compete for a market from which, because of small size and resources, they would otherwise be foreclosed—the market reached by the national brand companies. It has not adversely affected the competitive potential of the small independents, whose limited resources would, in any event, not have permitted them to engage in more than local advertising or to reach for the national advertiser's market.

Clearly, the territorial restriction "is not imposed by a party or parties with monopoly power" (*ibid*), and we do not understand the Government to be contending that it is.

While the territorial restriction does operate to reduce competition among licensees with respect to Serta-brand products, that reduction of competition is, in the light of transportation costs, the expertise of the licensees' distribution organization and other factors, minimal, compared with the enhanced competitive potential that the over-all Serta arrangement brings to the market and the dilution of that potential that would be caused by abrogating exclusivity. Also, the territorial restriction with respect to the use of the Serta marks does not restrain the licensees, who are

able to, and do, compete with other Serta licensees across territorial boundaries by offering and selling non-Serta mattresses.

As was said in the *Columbia Pictures* case:

> "... even on the assumption arguendo that there was a reduction in competition by reason of the attacked clauses, the validity of the ancillary restraint is to be determined in light of its reasonableness *as viewed under all the circumstances*" (p. 179; italics supplied).

Viewed under all the circumstances, the territorial restriction appears to be clearly valid. Moreover, it is both an "allowable protection against aggressive competitors" and "the only practicable means a small company has" for competing for the important consumer market reached by national advertising, see *White Motor Co.* v. *United States,* 372 U.S. 253, 263. Certainly, the territorial exclusive practice involved in this case cannot be said to be one of those "which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable and therefore illegal without inquiry as to the precise harm they have caused or the business excuse for their use," *Northern Pacific Co.* v. *United States,* 356 U.S. 1, 5. Properly concerned as this Court has been to apply the policy of the Congress to preserve the competitive role of small business and to avoid the trend towards industrial concentration (see *United States* v. *Von's Grocery Co.,* 384 U.S. 270; dissenting opinion of Mr. Justice Douglas in *Standard Oil Co.* v. *United States,* 337 U.S. 293, 315) it should affirm the validity of a practice which is both reasonable and necessary to the success of a trademark licensing program that has enabled small companies to compete against the giants of their industry.

CONCLUSION

The judgment below, as well as the principle that evidence relating to the competitive justification for territorial exclusives under a trademark license is admissible even in situations where an antitrust plaintiff has made out a *prima facie* case of restraint of trade, should be affirmed.

Respectfully submitted,

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APPENDIX[*]

SUGGESTED PRICES FOR MATTRESS LINES

TWIN AND DOUBLE BED MATTRESSES

Serta		*Simmons*		*Sealy*		*Stearns & Foster*		*Columbia*	
Serta Posture	$39.75	Olympic	$39.88	Golden Sleep Deluxe Golden Sleeper	$39.95 $39.95	Berkley Rodeo El Rancho Anniversary Special	$39.95 $39.95 $39.99	Delray	$39.95
Supreme	$49.75	Back Care 95th Anniversary	$49.88 $49.95	Quilt Supreme Golden Sleep Supreme	$49.95 $49.95	Viscount Anniversary Special	$49.95 $49.99		
Capri Ortholux Capri	$59.75 $59.75	Deep Sleep Deluxe	$59.95	Rest Guard	$59.95	Splendor	$59.95	Betsy Ross	$59.50
Serta-Rest Smooth-a-crat	$69.50 $69.95	N.A.		N.A.		Super Ladyfaire	$69.50	N.A.	
Perfect Sleeper	$79.50	Beauty Rest	$79.50	Posturepedic	$79.50	Correct Comfort	$79.50	Vertebracer	$79.50
Perfect Sleeper Imperial	$89.50	N.A.		N.A.		Queen Victoria	$89.00	N.A.	

[*] **Source: Shopping Survey (1965), prepared by MacManus, John & Adams, Inc., from information supplied by John M. Smyth Company, Carson, Pirie, Scott & Company, Marshall Field & Company and Serta Associates, Inc.**